its "business strategy to sign up both national and regional line-splitting partners and capitalize on the growing demand for bundled voice and data services" and announced two new line-splitting partnerships in July of this year.[249] Moreover, the advent of VoIP strengthens the Commission's conclusion in the *Triennial Review Order* that sufficient revenue opportunities exist to require data CLECs to pay for the entire loop. The near-zero cost for line sharing imposed by most states was based on the assumption that incumbents would recover most of the loop costs through their narrowband, circuit-switched voice service. Because VoIP replaces circuit-switched voice service, allowing line-sharing to continue at near-zero cost will exacerbate the "irrational cost advantage over competitive LECs purchasing the whole loop and over the incumbent LECs" that the elimination of line-sharing was designed to end. *Triennial Review Order* ¶ 260.

b. The commenters supporting the imposition of line sharing list various propositions that, they claim, the Commission relied on to support its decision to eliminate line sharing, and that, they further claim, have been proven incorrect in some respect. These lists represent a misunderstanding, or misrepresentation, of the *Triennial Review Order* and the realities of the marketplace.

First, they claim that the Commission expected data-only CLECs to partner with UNE-P CLECs in line-splitting arrangements, and that the elimination of UNE-P means that line-

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072704an.718, at 3 (July 27, 2004) ("It's important to remember that 68% of Covad's current revenue comes from business customers.").

[249] Covad Press Release, *Vartec and Excel Select Covad DSL for their Local/Long Distance Voice and Data Bundles* (Aug. 28, 2003) (quoting Charles Hoffman, President and CEO of Covad); *see* Covad Press Release, *Lightyear Network Solutions Selects Covad For Its Bundled Voice and Data Service* (July 27, 2004); Covad Press Release, *Met Tel Selects Covad DSL For Its Local and Long Distance Voice and Data Bundles* (July 6, 2004).

splitting is no longer a viable option. *See* Covad at 43; ALTS *et al.* at 48-49; EarthLink at 4-5. In fact, the Commission did not once mention UNE-P in connection with line sharing in the *Triennial Review Order*, much less suggest that its decision to eliminate line-sharing was based on the continued availability of UNE-P. Instead, line sharing was eliminated out of due regard for intermodal competition and to avoid "skew[ing] competitive LECs' incentives toward providing a broadband-only service to mass market consumers, rather than a voice-only service or, perhaps more importantly, a bundled voice and xDSL service offering." *Triennial Review Order* ¶ 261. And CLECs can now use VoIP to offer that bundled voice and broadband service.

Second, they opine that "narrowband UNE-L competition" is not a "viable strategy for entering the consumer market." Covad at 44; *see* EarthLink at 6. But, again, this statement is badly off point and simply not credible in light of Covad's recent announcements of new line-splitting partnerships and in light of the dozen pages of its comments that Covad devotes to puffing its own VoIP-plus-data offering as a viable strategy for entering the consumer market. That Covad and other data CLECs would *prefer* to maintain what the Commission rightly called an "irrational cost advantage," *Triennial Review Order* ¶ 260, rather than paying for a stand-alone loop, does not constitute impairment.

Third, they claim that the Commission should reinstate line sharing because few CLECs are earning revenues from video delivered via copper loops. *See* Covad at 44; EarthLink at 5-6. But the Commission never suggested that data service over an unbundled loop would be uneconomical if unaccompanied by video service. Instead, the Commission simply noted "that there are a number of services that can be provided over the stand-alone loop, including voice, voice over xDSL (i.e., VoDSL), data, and video services." *Triennial Review Order* ¶ 258. The

Commission anticipated, however, that competitors would sell "a bundled voice and xDSL service offering," *id.* ¶ 261, which is precisely what Covad is offering. And in fact, the advent of VoIP provides a new way for competitors to offer voice services to their broadband customers without the need to invest in circuit switches, further increasing revenue opportunities. Covad also appears to be offering, through partnerships with such companies as America Online and Speakeasy, other value-added broadband services that were not specifically mentioned by the Commission but that confirm the soundness of the Commission's logic.[250]

In any event, by mid-2004, moreover, some 60 local telephone companies in the U.S. were already offering cable-like video services using DSL technology.[251] In Canada, Japan,

[250] Covad Press Release, *America Online, Inc. and Covad Announce Cooperative "Broadband Connect" Relationship* (Mar. 11, 2004) (announcing "agreement to offer the next generation of broadband connectivity options to AOL for Broadband members"); Covad Press Release, *Covad and Speakeasy Unveil Faster Consumer DSL Service* (Jan. 28, 2004) (announcing collaboration "to bring higher bandwidth broadband service to Speakeasy's power Internet users throughout Covad's nationwide network").

[251] *See* ATM Forum White Paper, *Delivering Video over Packet Networks* at 9 (Apr. 2003) ("There are already 60 phone companies in the US providing digital video over DSL, and they are getting good take-up rates."); J. Moynihan *et al.*, Merrill Lynch, *Voice over Broadband* at 5 (June 24, 2003) ("Smaller telcos in both the U.S. and Canada have already gone ahead with major access network rebuilds needed to support video and higher-speed DSL services."); D. Briere & P. Hurley, Telechoice, *What's New with DSL TV?*, Network World Fusion (Apr. 27, 2004), *at* http://www.nwfusion.com/edge/columnists/2004/0426bleed.html (noting deployment in the U.S. of "video over ADSL solutions, combining local content, 'cable' channels and digital audio programming with high-speed Internet and voice services."); J. Reif-Cohen *et al.*, Merrill Lynch, *Cable Television: The Latest on Broadband Data and VoIP Services in North America* at 12 (Nov. 3, 2003) (estimating that Qwest provides DSL-based video services to approximately 40,000 customers); *More Consumers to Get High-Speed Broadband Connection*, Appliance (Jan. 1, 2004) (ABI Research "believes that video-over-DSL will be the new kid on the block in coming years, with U.S. incumbent local exchange carriers and competitive local exchange carriers charging ahead with aggressive deployments to fend off cable's triple-play offering.").

Korea, and Italy, video over DSL has already been widely deployed.[252] Hence, the Commission quite properly noted that there video represents one *potential* revenue stream for companies that obtain unbundled loops. And the fact remains that, if Covad wants to provide more extensive video offerings along with its broadband service, the Commission correctly found that it has the same ability as incumbents to deploy fiber networks.

Fourth, Covad complains that it has had difficulty reaching alternative commercial agreements with incumbent carriers to replace mandatory line sharing. *See* Covad at 45. Even if this were true, it would be beside the point, because the availability of unbundled loops and other platforms for reaching the end user makes it unnecessary for broadband service providers to reach agreements with ILECs in order for customers to benefit from broadband competition. In any event, Covad ignores the fact that Verizon has negotiated commercial agreements with Covad — and, more to the point, with *ISPs* like EarthLink — to provide the connectivity and features they desire, despite the planned phase-out of mandatory line sharing. *See* Verizon Comments at 153. If anything, the continuing regulatory uncertainty caused by the Commission's delay in denying EarthLink's petition to reinstate mandatory line sharing has made negotiating commercial replacements more difficult. Contracts are easier to negotiate when the background rules are clear to all parties.

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[252] D. Briere & P. Hurley, Telechoice, *What's New with DSL TV?*, Network World Fusion (Apr. 27, 2004), *at* http://www.nwfusion.com/edge/columnists/2004/0426bleed.html ("[P]roviders in Japan, Korea, Italy, and elsewhere have launched commercial video over DSL services."); J. Reif-Cohen *et al.*, Merrill Lynch, *Cable Television: The Latest on Broadband Data and VoIP Services in North America* at 12 (Nov. 3, 2003) ("In Canada, virtually all of the ILECs are pushing ahead with DSL-based video in some form." "Italy's Fastweb now has a 120-channel video service, available to 250K customers, delivered via either fiber or DSL." "In Hong Kong, broadband provider PCCW has launched its DSL-based "now [Broadband] TV" video service in August.").

Finally, Covad's argument that "[c]ost-allocation is not a reason to eliminate line sharing" is also beside the point. Covad at 46. The point is not only that the price of the UNE, which is at or near zero, is too low; it is that no ILEC should have to provision the UNE at all, other than on voluntarily negotiated terms, in the absence of an impairment finding — a finding that, in the current circumstances, cannot lawfully be made.

In sum, none of the supposed changed circumstances identified by the various commenters provides any basis for the Commission to reconsider its pro-competitive decision not to reimpose a line sharing obligation.

3. The Commission Should Reject Certain CLECs' Proposal for Mandatory "VoIP Hot-Cuts" As a Poor Solution to a Nonexistent Problem

Covad and ALTS argue that a form of line-sharing should be preserved to facilitate the transfer of ILEC customers to a CLEC's particular brand of VoIP service. Specifically, they ask that CLECs be allowed to line-share over ILEC POTS service just long enough to establish and test their own VoIP service, so that the phone number can be ported to the new VoIP service. *See* Covad at 64-67; ALTS *et al.* at 50. Although Covad claims that this intrusive new procedure is necessary for a customer to switch from ILEC voice service to VoIP over CLEC-provided DSL using a stand-alone loop, *see* Covad at 61-62, what Covad actually seeks is an advantage over other VoIP competitors. While ILECs would be forced to subsidize CLEC efforts to acquire customers, other VoIP providers would have to bear the full costs of their customer acquisition efforts. For example, AT&T and Lingo offer customers their first month of service free, to permit them to establish and test VoIP service.[253] Because the need to convince customers to switch providers is common to "virtually any new entrant in any sector of the

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[253] *See* https://www.lingo.com/guWeb/; http://www.usa.att.com/callvantage/index.jsp?.

economy, no matter how competitive the sector," it cannot justify imposing an unbundling requirement. *USTA I*, 290 F.3d at 426.

In any event, there is no need for any customer to cut off ILEC voice service before establishing and testing VoIP service. Customers, for example, can try out a CLEC's VoIP provided over ILEC DSL or via an intermodal competitor like cable modem service without interfering with their POTS service in any way. Accordingly, there is no need for a customer to give up ILEC POTS before being satisfied that his or her VoIP service is functioning satisfactorily. The Commission may not ignore these options before imposing the form of line sharing the CLECs are seeking. *See, e.g.*, *USTA II*, 359 F.3d at 570 ("the Commission cannot proceed by very broad national categories . . . without exploring the possibility of more nuanced alternatives and reasonably rejecting them" (citing *USTA I*, 290 F.3d at 425-26)).

D. There Is No Basis for the Commission To Reconsider Its Decision To Refrain from Unbundling the Next-Generation Network, Packetized Capabilities of Hybrid Loops

In one of the more bizarre passages in the comments submitted in this proceeding, Covad says that "the court of appeals [for the D.C. Circuit] itself recognized" that "the *TRO* misapprehended the harm that unbundling of legacy hybrid loops would cause to the ILECs." Covad at 57 (citing *USTA II*, 359 F.3d at 580-81). In reality, the cited portion of *USTA II affirms* the Commission's decision not to require unbundling of the next-generation network, packetized capabilities of hybrid loops, and it specifically identifies three bases for the Commission's decision "to which the CLEC response is either inadequate or non-existent." 359 F.3d at 581. First, "greater incentives may be needed for ILECs to deploy the additional electronic equipment needed to provide broadband access over a hybrid loop"; second, "limiting access to ILEC fiber facilities increases incumbents' incentives to develop and deploy FTTH"; and third, "unbundling hybrid loops would deter CLECs themselves from investing in deploying their own facilities, possibly using different technology." *Id.*

Covad fails to address these three points, much less to provide an adequate response to them. Nor does Covad confront the Commission's unequivocal statement that, due to the intermodal competition that characterizes the broadband market, tailoring its "unbundling requirements to most effectively address those services that are not yet fully subject to competition (*i.e.*, narrowband services in the mass market) rather than the broadband services that are currently provided in a competitive environment." *Triennial Review Order* ¶ 292.

Instead, Covad postulates that the Commission simply did not mean what it said in the *Triennial Review Order* and that, rather than establishing the easy-to-apply, bright-line rule that packetized capabilities should not be unbundled, the Commission somehow *meant* to establish the hard-to-apply, fuzzy rule that "innovative, new technologies" should not be unbundled, "as opposed to the legacy hybrid loop facilities that the ILECs had been deploying for decades." Covad at 57. (Even more illogical is the thematically related argument by the Loop and Transport Coalition (at 150) that DS1 and DS3 loops should be deemed "TDM-based," even when those loops do not, in fact, have TDM features and functions.)

The short answer to these arguments is that Covad made the same arguments to the Commission before the *Triennial Review Order* was issued, then it made them again on appeal, and its arguments were rejected in both instances. The Commission meant what it said in the *Triennial Review Order*, and its decision has been upheld on appeal. The record contains no facts that would support an about-face by the Commission under these circumstances.

VII. OTHER ISSUES

A. The Commission Should Not Impose Combinations Requirements for 271 Elements

In the *Triennial Review Order*, the Commission held — and the D.C. Circuit affirmed — that BOCs are not required, "pursuant to section 271, to combine network elements that no longer are required to be unbundled under section 251." *Id.* ¶ 656 n.1990; *see USTA II*, 359 F.3d at 589-90. The Commission here should reaffirm that BOCs have no obligation to combine 271 elements with each other or with elements required to be provided under § 251, and should hold that such a rule is consistent with § 202, an issue the D.C. Circuit left open. *See USTA II*, 359 F.3d at 590.

Section 202 prohibits only "*unjust or unreasonable* discrimination in . . . practices . . . for or in connection with *like communication service*." 47 U.S.C. § 202(a) (emphases added). The Commission has already held — and the D.C. Circuit has affirmed — "that an integrated service package is not 'like' its component services purchased individually." *Competitive Telecomms. Ass'n v. FCC*, 998 F.2d 1058, 1061 (D.C. Cir. 1993). Because 271 elements are "component services" and not the "integrated service packages" that retail customers purchase, any claim that a refusal to combine 271 elements — with each other or with elements under § 251 — violates § 202 fails at the outset.

But such claims also fail for an independent reason. It would be neither unjust nor unreasonable for BOCs to refuse to provide combinations that include 271 elements, or to combine them on terms different from those applicable to retail customers. When the Supreme Court upheld the Commission's combination rules for *UNEs*, it did so based on its finding that they "remove practical barriers to competitive entry into local-exchange markets while avoiding serious interference with incumbent network operations." *Verizon*, 535 U.S. at 535. For 271 elements, however, there are no "practical barriers to competitive entry" — that is precisely the consequence of the Commission's failure to find that competitors are impaired without UNE access to such elements. Therefore, there is no need for a combinations rule to ensure nondiscriminatory service.

Finally, mandating terms and conditions for 271 elements is inconsistent with the Commission's determination that 271 elements must be offered at *market* rates, terms, and conditions. *See Triennial Review Order* ¶ 664; *UNE Remand Order* ¶ 473.[254] Regulatory mandates — whether for rates or the terms and conditions on which 271 elements are offered — are directly contrary to the Commission's preference for 271 elements to be governed by market transactions. Indeed, it would be "counterproductive" to mandate that BOCs combine 271 elements, whether with other such elements or elements provided under § 251, because it would encourage CLECs to resell the BOCs' networks even where the Commission has not found impairment. *UNE Remand Order* ¶ 473. This mandated sharing of non-bottleneck elements would be directly contrary to the Supreme Court's rationale for upholding TELRIC, that "competition as to 'unshared' elements may . . . only be possible if incumbents simultaneously share with entrants some costly-to-duplicate elements." *Verizon*, 535 U.S. at 510 & n.27.

[254] As explained above, the Commission has already expressly held that § 201 and § 202 do not require 271 elements to be provided at TELRIC or other forward-looking rates. Indeed, interpreting those sections, the Commission has held that mandating forward-looking rates for 271 elements would be "counterproductive" and is "no[t] necessary to protect the public interest." *Triennial Review Order* ¶ 656; *UNE Remand Order* ¶ 473; *see supra* p. 144. The courts of appeals, moreover, have repeatedly affirmed the Commission's conclusion that § 201 and § 202 permit reliance on market forces and do not compel the Commission to mandate cost-based rates. *See, e.g., Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d 313, 324 (5th Cir. 2001); *Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997).

Only a handful of commenters argue that the Commission should reverse its determination in the *Triennial Review Order* and impose a combinations requirement for 271 elements. *See* Loop & Transport at 136-38; PACE *et al.* at 112-14; Sprint at 67-68; ATX *et al.* at 44-45. But none of these commenters even quotes the text of § 202, much less demonstrates that a refusal to combine 271 elements, whether with each other or with elements under § 251, fails the established, three-part test for identifying violations of § 202. *See, e.g., CompTel*, 998 F.2d at 1061. In any event, the few arguments they do raise lack merit.

First, they argue that the Supreme Court's reasons for upholding the Commission's combinations rules for UNEs require the Commission to adopt similar rules for 271 elements. *See* Loop & Transport at 114. As shown above, however, the Court's basis for upholding the UNE combination rule is inapplicable to 271 elements — the absence of a finding of impairment means that there are no "practical barriers to competitive entry" to be overcome. *Verizon*, 535 U.S. at 535. These CLECs, moreover, overlook that the Commission has held that "Congress did not intend that the term 'nondiscriminatory' in the 1996 Act be synonymous with 'unjust and unreasonable discrimination' used in the 1934 Act, but rather, intended a *more stringent standard*" in § 251(c). *Local Competition Order*[255] ¶ 217 (emphasis added). The Court's ruling in *Verizon*, therefore, imposes no limitation on the Commission's interpretation of the *less* stringent standard in § 202.[256]

[255] First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996) ("*Local Competition Order*") (subsequent history omitted).

[256] For the same reasons, the CLECs' reliance on the Commission's routine network modifications rules, which implement § 251(c)(3) *not* § 202, is misplaced. *See* Loop & Transport at 113.

Second, they claim that the Commission concluded in the *Triennial Review Order* that a refusal to combine 271 elements with elements available under § 251 violates § 202. *See* PACE *et al.* at 113-14 (citing *Triennial Review Order* ¶ 581). But the Commission's conclusion there was expressly limited to the requirement that incumbents "modify[] their interstate access service tariffs to expressly permit connections with UNEs and UNE combinations." *Triennial Review Order* ¶ 581. The Commission did not address BOCs' obligations under § 271 in that paragraph. Instead, the *Triennial Review Order* addressed that issue in two other places. In the course of discussing BOCs' obligations under § 271, the Commission expressly "decline[d] to apply [its] commingling rule . . . to services that must be offered pursuant to . . . checklist items" 4 through 6 and 10. *Id.* ¶ 655 n.1990. Although the Commission had earlier stated, in a paragraph dealing with the resale obligations of all ILECs, that "*incumbent LECs* [must] permit commingling of UNEs and UNE combinations with other wholesale facilities and services, including any network elements unbundled pursuant to section 271," *id.* ¶ 584 (emphasis added), the Commission revised that sentence to remove any reference to § 271, which applies to BOCs, not incumbent LECs, *see Errata* ¶ 27. Although the Commission simultaneously deleted the sentence in footnote 1990 that directly addressed this issue, *see id.* ¶ 31, the deletion of the reference to 271 elements in paragraph 584 rendered that sentence superfluous. Nonetheless, to avoid any confusion on this issue, the Commission should grant BellSouth's petition for clarification and confirm that any rule the Commission adopts in this proceeding that requires incumbents to combine UNEs with other elements does not apply to 271 elements.

B. The Commission Should Reject the Loop and Transport Coalition's Untimely Petition for Reconsideration of the Commission's Routine Network Modification Rules

In its comments, the Loop and Transport Coalition requests that the Commission modify its routine network modification rules in three respects. *See* Loop & Transport at 121-25. These requests should be denied.

First, they seek a ruling that every interconnection agreement in effect today requires incumbents to perform routine network modifications consistent with the rules adopted in the *Triennial Review Order*. To the extent they are seeking to have the Commission issue an order construing the terms of these agreements "without reference to a specific agreement or agreements," such an order would be unlawful — interconnection agreements can only be interpreted by reference to their terms. *Pacific Bell v. Pac West Telecomm, Inc.*, 325 F.3d 1114, 1125-26 (9th Cir. 2003). Agreements, for example, may expressly provide that incumbents do not have to perform any or all of the network modifications required by the Commission's rules. The Loop and Transport Coalition has not identified a single provision of any agreement, much less provided the Commission with the record necessary to interpret those agreements, as they appear to request that the Commission do.

Second, they ask the Commission to rule that "costs for routine network modifications already are (or at least should be) incorporated into the ILECs' TELRIC-based rates for unbundled high-capacity loops." Loop & Transport at 124. As an initial matter, the Commission could not hold that such costs "already are" included in existing TELRIC rates without an exhaustive and fact-intensive investigation into what costs state commissions included in their TELRIC rates. Such a ruling, moreover, would conflict with the Commission's determination that ILECs are entitled to "recover the cost of the routine network modifications [the Commission] require[d]" in any state that did not include such costs in their existing rates. *Triennial Review Order* ¶ 640. The Commission has also previously rejected the claim that the costs of routine network modifications must be recovered through the recurring rates for high-capacity UNE loops, finding that "[s]tate commissions have discretion as to whether these costs should be recovered through non-recurring charges or recurring charges." *Id.* Nor is there any reason to mandate that recovery of the costs of routine network modifications be spread over the costs of all high-capacity facilities. Only some high-capacity facilities will require modifications, and the specific CLECs that obtain such facilities should bear those costs.

Third, they seek a ruling that "ILECs may charge a separate fee for routine network modification only if they charge their own retail customers for such services in comparable situations." Loop & Transport at 125. This is simply another attempt to force incumbents to recover the costs of routine network modifications through recurring charges for high-capacity facilities, which this Commission has already rejected. Incumbents have generally made the decision to spread the costs of any necessary network modifications across all of their retail customers; CLECs have the same ability to adopt such a retail billing practice. But that does not change the fact that different wholesale orders will impose different costs on the incumbent, depending on whether network modifications are required. Recovering those costs from the specific CLECs that order those more expensive facilities, through non-recurring charges, is an eminently sensible approach, as the Commission recognized by giving state commissions the authority to adopt that approach. *See Triennial Review Order* ¶ 640. As the Sixth Circuit has recognized, there is no discrimination in utilizing different wholesale and retail billing practices;

if competitors "want[] to be treated like retail customers, [they] can pay . . . wholesale rates according to a scheme based on retail rates and then resell such service[s]." *Michigan Bell Tel. Co. v. Strand*, 305 F.3d 580, 591-92 (6th Cir. 2002).

CONCLUSION

For the foregoing reasons, the Commission should resolve the issues in this proceeding in accordance with these Comments.

Respectfully submitted,

Scott H. Angstreich
J.C. Rozendaal
KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.
Sumner Square
1615 M Street, N.W.
Suite 400
Washington, DC 20036
(202) 326-7900

Michael E. Glover
Edward Shakin
Karen Zacharia
Sherry A. Ingram
Julie Chen Clocker
Ann Rakestraw
VERIZON
1515 North Courthouse Road
Suite 500
Arlington, VA 22201-2909
(703) 351-3071

Samir Jain
Wilmer Cutler Pickering Hale and Dorr LLP
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006
(202) 663-6083

James G. Pachulski
TechNet Law Group, P.C.
1100 New York Avenue, N.W.
Suite 365
Washington, DC 20005
(202) 589-0120

Counsel for Verizon

October 19, 2004

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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OCT 1 9 2004

Federal Communications Commission
Office of Secretary

In the Matter of	
Unbundled Access to Network Elements	WC Docket No. 04-313
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	CC Docket No. 01-338

ATTACHMENTS TO VERIZON REPLY COMMENTS

Tab	Declarant	Subject
A	Alfred E. Kahn and Timothy J. Tardiff	Impairment
B	Ronald H. Lataille, Marion C. Jordan, and Julie K. Slattery	Competitive Data
C	William E. Taylor	Special Access Pricing
D	Robert F. Pilgrim	Competitive Fiber
E	Claudia P. Cuddy	Out-of-Region Markets
F	Lynn W. Walker	State Proceedings
G	Thomas Maguire	Hot Cuts
H	Robert W. Crandall and Hal J. Singer	Impairment
I	Jeffrey H. Rohlfs and Joseph H. Weber	MCI's Impairment Analysis
J	Carrier Materials	
K	Examples of Non-UNE Competitors That Did Not Submit Comments	

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Unbundled Access to Network Elements	)	WC Docket No. 04-313
	)	
Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers	)))	CC Docket No. 01-338

REPLY DECLARATION OF ALFRED E. KAHN AND TIMOTHY J. TARDIFF SUBMITTED IN SUPPORT OF THE COMMENTS OF THE VERIZON TELEPHONE COMPANIES

1. My name is Alfred E. Kahn. I submitted a Declaration in this proceeding on October 4, 2004. My qualifications are set forth in that Declaration.

2. My name is Timothy J. Tardiff. I submitted a Declaration in this proceeding on October 4, 2004. My qualifications are set forth in that Declaration.

Introduction and Summary

3. As we explained in our opening declaration, the telecommunications market is evolving in ways similar to other capital-intensive industries such as transportation—today, there is significant and increasingly intense facilities-based intermodal competition between local exchange carriers, cable companies, wireless, and voice over Internet protocol (VoIP) providers. Given these technological and market developments, as well as the large economies of scale and scope inherent in the provision of telecommunications services, an

efficient competitive market is likely to be composed of a relatively small number of large, well-capitalized competitors that have the requisite scale and scope to compete effectively. There is little reason to expect that a competitive market in a capital-intensive industry such as telecommunications would include numerous small players, vying with one another for some small share of the total. It would therefore be irrational for regulatory policy to be aimed at creating such an industry structure or to impose the costs associated with mandatory unbundling for the purpose of ensuring the presence of smaller niche carriers, in order to create the appearance of more competition, *particularly because of the evidence that such efforts actually discourage the more important facilities-based competitive entry.*

4. In determining when and if unbundling should be required, the Commission must use market definitions that reflect the realities of such facilities-based, intermodal and intramodal competition. With respect to switching, the emergence of VoIP, cable-based telephony, and wireless services means that competitive conditions are both actually and, even more, potentially homogeneous nationally. Just as it has done with interLATA long distance service, the Commission should therefore define the geographic market as national in scope. In the case of transport, the relevant geographic market is the metropolitan statistical area (MSA), not individual routes: the key inquiry is not how many pipes are currently available between two locations, but whether customers have a competitive choice in terms of firms to provide that facility. The fact that the customer then chooses one provider and therefore does not have multiple fibers to its location does not in itself dictate a conclusion that the market is non-competitive; it merely transfers the focus of the

competitive analysis to the availability or non-availability of competitive providers of that or alternative kinds of facilities at the time of their construction or installation.

Unbundling Obligations Should Be Consistent with the Inherent Characteristics of the Telecommunications Industry.

5. The competitive local exchange carriers (CLECs) collectively[1] and Dr. Pelcovits, on behalf of MCI,[2] have proposed that the impairment analysis on the basis of which it is determined whether incumbent local exchange carriers (ILECs) should or should not be required to make particular unbundled network elements (UNEs) available to competitors at total-element long-run incremental cost (TELRIC) prices should concentrate on the likely effect of such an obligation—or of the decision not to impose such an obligation—on how competitive downstream markets likely would be in those two eventualities. While the focus on competition in downstream—that is, retail or resale—markets is in principle unexceptionable, crucial to any such determination is an assessment of the effect of any such obligation on competition at the production level. *That is the level to which the FCC's entirely correct expressed preference for facilities-based over non-facilities-based competition would apply.*

6. As we described in our opening declaration, the growing strength of intermodal competition has substantially changed the telecommunications landscape, even in the few short years since the FCC last reviewed its unbundling prescriptions. The foundations of that

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[1] "Mayo/MiCRA/Bates White Economic Impairment Analysis," *ex parte presentation* on behalf of a coalition of CLEC sponsors, Federal Communications Commission WC Docket No. 04-313 and CC Docket No. 01-338, October 4, 2004.

[2] Declaration of Michael Pelcovits, Attached to Comments of MCI, in WC Docket No. 04-313 and CC Docket No. 01-338 (October 4, 2004).

competition are, emphatically, at the "manufacturing" level—that is to say in *producing* the several telecommunications services, rather than merely retailing one of them—traditional, historical wireline service, local and long-distance, and its comparatively recent additional features such as Call Waiting and Caller ID. The retail competition that it generates is essentially derivative from and dependent on that competitive production upstream. And just as establishing prices for unbundled elements under existing TELRIC rules essentially forces regulators to make predictions of the results that a competitive industry would produce, determining whether competition would be impaired absent the availability to competitors of certain network elements at TELRIC prices requires similar kinds of predictions: the impairment criterion implicitly involves predicting the kind of industry *structure* necessary to produce efficient competitive outcomes and, also implicitly, whether mandatory sharing would be conducive or pose obstacles to their achievement.

7. The industry structure that is emerging with the growth of intermodal competition departs from the theoretical perfectly or purely competitive model, both of which assume standardized services offered by numerous homogeneous firms.[3] Trying to impose such a competitive structure by continuing obsolete unbundling requirements is a hopeless task, and ultimately counterproductive. In light of the growth in intermodal competition, there is certainly no need to subsidize CLEC entry simply to create additional sellers (in the case of the UNE platform (UNE-P), mere resellers) of one particular mode: cable TV companies, wireless carriers, and VoIP providers are already capturing customers and traffic from

[3] The proposition that capital-intensive network industries tend to be relatively concentrated (rather than perfectly competitive) can be readily observed. For example, there are only a handful of major airlines nationwide and even fewer in particular segments of the market, such as routes connecting major hubs with spoke cities.

incumbents and have generated the efficiency- and innovation-enhancing incentives of facilities-based competition. To continue to require that certain ILEC UNEs be made available to competitors at Commission-set prices—all the more so at levels below the incumbents' actual forward-looking costs—will only distort and impede the development of efficient competition.

8. At this point, it will be helpful to confront directly the *kind* of competition that the Commission would be best advised to facilitate, particularly because this is one important subject of testimony of Dr. Pelcovits, on behalf of MCI. He recommends that the Commission apply the standard of "workable" or "effective" rather than "pure" competition in judging whether specific network elements satisfy the impairment criteria for requiring that they be made available to competitors.[4] In point of fact, however, it is he who is implicitly advocating the latter standard and we the former.

9. The essential condition of theoretically "pure" competition is the presence of a number of sellers of a standardized product sufficient to deny any one of them the ability to influence price. The "workable" or "effective" competition standard was proffered in the late 1940s and early to mid '50s as superior to pure competition standard in the application of the antitrust laws, and specifically in criticism of antitrust decisions in that same period intended to remove impediments to ("pure") competitive entry posed by such business practices of incumbent firms as exclusive dealing, tie-ins, refusals to deal, price discrimination, vertical integration, and agglomeration of patents accompanied with a

[4] MCI's Pelcovits Declaration at ¶ 8.

refusal to license competitors. The contention was that those decisions betrayed a hostility to mere fewness of sellers and to mere business size and integration, such as would frequently be both the prerequisite and the outcome of "effective," efficient and dynamic competition—consisting in and producing all-important improvements in efficiency and product innovations.

10. In the terms of the issues confronting the Commission in the present instance, this line of argument would clearly involve a preference for facilities-based competition, at the production level, over non-facilities-based competition at retail, the latter requiring a sharing by the more efficient or innovative of their advantages in order to permit merely imitative resale competition.

11. The workable competition proponents argued that effective competition frequently involves applications of new technology, the development of new, superior products and services or methods of production or distribution, the encouragement of which would ordinarily require acceptance of profit margins—the more valuable the innovations or competitive practices, the wider the margins[5]—earned by the successful practitioners; and that government-mandated sharing of those advantages with competitors, in the interest of making competition more *pure*, discourages the more effective, dynamic competition.

12. While proclaiming the superiority of the "workably competitive" over the "perfectly competitive" standard,[6] in fact, by calling for the mandated sharing of any such competitive

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[5] *The Economist* cites an American study that "found that the overall rate of return for some 17 successful innovations made in the 1970s averaged 56%." ("Innovation in Industry," Supplement, *The Economist*, February 20, 1999, unpaginated)

[6] MCI's Pelcovits Declaration at ¶ 8.

advantages so that "a sufficient number of CLECs...can achieve a minimum viable scale and overcome other barriers to entry,"[7] Dr. Pelcovits is in effect adopting the pure competition standard, which calls for the equation of prices and marginal costs:

> At one extreme, if only an 'advantaged' CLEC or two can enter, then the market will become a duopoly or triopoly, which will result in high prices and sub-optimal performance [read: prices well above marginal costs] in the downstream markets.[8]

13. Indeed, the advocacy of the "workable" or "effective" competition in preference to the pure competition model was premised on a recognition that the achievement of competitive advantage through product or service innovation—inherently inter- rather than intramodal—would ordinarily *require* the prospect of *not* having to share with competitors the advantages of successful innovation. In short, Dr. Pelcovits ignores the entire context in which the criterion of "workable" or "effective" competition was developed—resulting in a policy prescription or implication with a bias *against* the governmentally-mandated sharing of the benefits of successful, facilities-based, intermodal innovation.

14. So, again, notwithstanding Dr. Pelcovits' expression of preference for "workable competition in downstream markets"—

> Intermodal competition should 'count' towards a finding of no impairment *only to the extent* that the competitor helps create workable competition in downstream markets[9]—

he clearly implies a preference for pure competition—driving prices of existing, standardized services to marginal costs—over effective, dynamic real world competition.

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[7] MCI's Pelcovits Declaration at ¶ 9.

[8] MCI's Pelcovits Declaration at ¶ 10.

[9] MCI's Pelcovits Declaration at ¶ 14 (emphasis added).

This is not to deny there may be creative competition downstream as well. But the preference expressed by the Act itself and the Commission for *facilities-based* competition[10]—and by the assertion of its Chairman that switching is the "brains" of the most effective competitive process[11]—clearly implies a preference for innovative competition in the *production* of services, i.e., at wholesale, over retail or resale, and, correspondingly, for dynamic intermodal over imitative "purer" intramodal competition. This stands in direct contradiction of Dr. Pelcovits' assertions that

> Competition from <u>inter</u>modal service providers...does not provide evidence on whether <u>intra</u>modal CLECs can enter the market profitably without certain UNEs, such as switching

and

> At best, the cable competitor will form a duopoly along with the ILEC and contribute nothing to easing entry barriers faced by CLECs that do not own their own loops.[12]

Actually, as we demonstrated in our opening declaration, his characterization of the market structure at the "production" or "facilities" level as a "duopoly" minimizes the facilities-based competition that already confronts a great majority of customers and the greater effectiveness of competition among them than of the downstream competition encouraged by the mandatory sharing of the facilities of the incumbents.

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[10] See, for example, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 18 FCC Rcd 16978, ¶ 3 (2003). ("*Triennial Review Order*" or "*TRO*").

[11] Separate Statement of Chairman Michael K. Powell, Dissenting in Part, attached to FCC press release, "FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Phone Carriers," February 20, 2003.

[12] MCI's Pelcovits Declaration at ¶ 15.

15. The FCC's 2003 Triennial Review Order properly recognizes that the unbundling obligation should not be linked to the fortunes of particular firms and/or types of firms pursuing particular business plans.[13] Such niche providers may have network and cost structures incapable of taking advantage of the scale and scope economies that successful competitors have to be able to exploit, in an industry in which facilities-based competition is between or among capital- and technology-intensive networks. In this light, Dr. Pelcovits' attempt to limit the firms at issue about whose viability the Commission should be concerned in assessing impairment for mass market switching to those that use ILEC-supplied UNE loops[14] and his insistence that the FCC's unbundling rules allow enough of them pursuing this strategy to reach minimal viable scale[15] is an outcome-driven prescription likely to impair rather than improve dynamic competition in an increasingly multi-modal world. Just as the D.C. Circuit and ultimately the FCC have recognized that service providers piggy-backing on ILEC facilities are not the critical vehicles of powerful competition for high-speed Internet access, so the forced accommodation of such CLECs is increasingly problematic for local exchange and exchange access competition in general, because it involves the imposition of differential burdens and disincentives to investment on one set of competitors, operating in a single mode but subject to increasingly intense intermodal competition, inherently facilities-based.

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[13] *TRO* ¶ 115.

[14] MCI's Pelcovits Declaration at ¶ 37.

[15] MCI's Pelcovits Declaration at ¶ 9.

16. Recent history provides a dramatic example of the way in which excessively generous availability of UNEs—and UNE-Ps—while arguably increasing the "purity" of competition downstream are the enemy of effective and dynamic competition upstream: the largest users of UNE-Ps available until recently at increasingly attractive prices, were not small resellers, incapable of mounting their own facilities-based efforts, but, most prominently, AT&T and MCI. And AT&T's reaction to the Circuit Court of Appeals decision overturning the unbundling rules for mass market switching promulgated in the FCC's 2003 TRO and the news that the Solicitor General was not going to appeal that decision was an announcement that it was going to withdraw from its extensive resale offerings to retail customers.[16] And, much more significant, it proclaimed AT&T's dramatic shift of focus from traditional residential services to employment of emerging technologies—in particular, its expansion of VoIP in 28 markets, increasing its presence to 100 major markets in 32 states and the District of Columbia—a dramatic demonstration of the proposition that the availability of cheap, imitative "piggy-back" competition, intended to make it more "pure," had actually discouraged the far more "effective" dynamic intermodal competition.

17. Another example of the way in which excessively generous availability of UNEs undermines effective, dynamic competition is provided by the experience of high capacity facilities. The customers for such services are typically large businesses with large volumes of traffic, which tend to be concentrated in major metropolitan areas. These customers

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[16] "AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services; Concentrate Efforts on Business Markets," Press Release, July 22, 2004.

were the initial target of competing carriers as they began to enter local markets, long before the 1996 Act. These competitors initially deployed their own fiber optic facilities to serve the largest of those customers, in the most concentrated metropolitan areas, supplementing their own facilities with special access services purchased from the incumbent, typically at volume and term discounts. The FCC facilitated these developments through such measures as collocation requirements, permitting competing carriers to exchange traffic and to supplement their reach with services purchased from the incumbents. The result has been that competing carriers have continued to deploy high capacity facilities of their own only where it made economic sense for them to do so.

18. This process directly parallels the way in which competition developed in the long distance business. In that market, new competitors such as MCI and Sprint initially had few facilities of their own, supplementing and extending the reach of those networks with services purchased from AT&T at volume and term discounts. Over time, these competing carriers constructed more facilities of their own, eventually building out nationwide networks rivaling AT&T's. The imposition of overly generous unbundling obligations on high capacity facilities, at artificially low TELRIC prices, would clearly have directly undermined the successful introduction of facilities-based competition such as has already occurred, as well as forestall the continued deployment of competing facilities in favor of reliance on the incumbents' networks in the future.

19. As we pointed out in our opening declaration, the D.C. Circuit's *USTA I* decision directed that a finding of impairment be linked in some way to the presence of conditions of natural monopoly. Emphasizing the greater strictness of that condition, it added: "To rely on cost

disparities that are universal as between new entrants and incumbents in *any* industry is to invoke a concept too broad, even in support of an *initial* mandate, to be reasonably linked to the purpose of the Act's unbundling provisions."[17] The "universal" cost disadvantages that the Court explicitly excluded would embrace start-up as well as ongoing costs—such as the one-time costs that CLECs using UNE loops incur in signing up customers;[18] VoIP service providers, both ILECs and CLECs, likewise incur up-front costs in the form of the equipment that translates voice communications into data that can be transported on the Internet. The similar costs facing particular CLECs are relevant in assessing impairment only if they contribute to the tendency of the network element in question to exhibit characteristics of natural monopoly.

20. The competing networks of the emerging intermodal competitors are highly capital-intensive, using assets that are subject to rapid technological change. As we have pointed out many times in the context of TELRIC pricing,[19] investments in such situations are subject to high risks of technological displacement. In competitive markets, these risks would be reflected in much higher prices for services that are supplied on a monthly basis than for outright purchases whether on installment or under long-term agreements. In its 1996 *Local Competition Order*, the FCC in principle recognized these inherent risks as a

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[17] *United States Telecom Ass'n. v. FCC,* 290 F.3d 415, 427 (D.C. Cir. 2002), *cert. denied*, 538 U.S. 940 (2003).

[18] ILECs also incur such costs—for example, in accommodating changes in the location of their customers—although these are likely to differ from the costs that CLECs incur in acquiring new customers. As both inter- and intra-modal competition intensifies, however, the ILECs will presumably find themselves incurring customer acquisition and retention costs approximating those of their competitors.

[19] See, for example, Alfred E. Kahn, *Lessons from Deregulation: Telecommunications and Airlines After the Crunch,* AEI-Brookings Joint Center for Regulatory Studies, 2004, p. 30.

factor to be considered in setting TELRIC prices, observing also that long-term contracts mitigate such risks and, therefore, the competitive cost of capital.[20] Accordingly, the fact that ILECs offer lower monthly prices when buyers agree to purchase special access services under longer contract terms is entirely consistent with the way in which competitive markets function and is not evidence of competitive impairment justifying mandatory unbundling.

21. Similarly, an industry structure typified by capital-intensive costs for assets with relatively long lives implies that an assessment of the profitability of entry and ongoing operations must be over the time horizon of the business decisions that entry and subsequent operations imply. In particular, short-term measurements of profits, particularly in the early years after entry, are not proper indicators of the economic viability of competitive entry. Consistent with the D.C. Circuit's admonition that cost disparities that occur in competitive industries have no place in an impairment assessment, the fact that entrants in capital-intensive industries may require some number of years to realize sufficient profits is a normal characteristic of such competition.

Market Definition

High-Capacity Loops and Transport Facilities

22. In our opening declaration, we explained why the route-by-route or location-by-location geographic market definition specified in the TRO (and defended by CLEC commentors[21])

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[20] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, 11 FCC Rcd 15499, ¶ 687 (1996).

[21] *See, e.g.*, MCI Comments at 12-14.

for high-capacity loops and transport is much too narrow and should instead be an MSA.[22] Among other reasons, we pointed out that, consistently with the FCC's determination in its *Special Access Price Flexibility Order*, CLECs enter and compete on a metropolitan-area basis, and that the presence of competing facilities at nearby locations constrains prices over an area wider than the individual route.

23. An additional infirmity of the overly granular definition is its implicit assumption that an unregulated competitive market would at all times offer every purchaser of high-capacity loops and transport services multiple suppliers, among whom customers could choose in making their purchases—that is to say, that in a competitive market there would be multiple pipes along every route. That expectation is of course entirely unrealistic; more directly pertinent, it would be unnecessary for the benefits of competition to be realized. In the case of goods and services with relatively long asset lives, it is not unusual for firms to compete over which of them will supply them to particular customers, who would in turn proceed to use them for some period of time. The locus of competition is in the original leasing: whether or not it is effective depends on whether customers in particular locations have a competitive choice among suppliers to lay fiber along a particular route to serve them. And, because carriers that have facilities along nearby routes will also be potential suppliers for customers at particular locations, the relevant geographic market for high capacity loops and transport facilities is the MSA, not individual locations or routes.

[22] Declaration of Alfred E. Kahn and Timothy J. Tardiff in WC Docket No. 04-313 and CC Docket No. 01-338 (October 4, 2004) at ¶ 15.